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# Post-Mortem Estate Planning

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# POST-MORTEM ESTATE PLANNING

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The testator's death does not necessarily terminate the opportunity to make plans that can result in financial advantages to his estate and thereby the beneficiaries. Rather, the modern estate planner may undo what seemingly were good testamentary estate plans or, to the extent possible, correct poorly conceived plans. This re-evaluation in an effort to obtain the maximum tax benefits is called "Post-Mortem Estate Planning." Therefore, a basic understanding and awareness of the methods available and goals to be achieved in effecting this plan are essential for the skillful administration of the decedent's estate.

Basically, two primary goals can be achieved by after death planning. First, selecting the proper course of action can result in an immediate tax benefit to the estate and/or the beneficiaries, or well considered planning may create a status that makes possible tax savings beyond the immediate tax consequences.[1] Secondly, a post-mortem plan may be used to thaw benefits which have become frozen or unduly restricted; powers of appointment may be exercised to adapt distribution plans to current needs; and ways to safeguard investments of widows and children can be devised.[2] To achieve these results, the following methods for effectuating an overall post-mortem plan should be given consideration by the executor and/or attorney. The impact of any plan should be examined in the following areas of the tax law: (1) Estate Tax, (2) Income Tax, and (3) The Inter-relation between the Estate Tax and Income Tax.

## ESTATE TAX CONSIDERATIONS

At least five different methods of effecting a post-mortem estate plan have a direct effect upon the estate tax. First, and probably foremost because of its impact on the all-important marital deduction, is the ELECTION TO TAKE AGAINST THE WILL.[3] Estate tax savings may be realized through utilization of the election where the intended marital deduction fails to qualify because one of the five statutory requirements is lacking, or if for any other reason the value of property interest passing to the surviving spouse falls short of the maximum marital deduction available.[4] Thus,

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1. Price, *Post-Mortem Estate Planning,* 15th N. Y. U. INST. ON FED. TAXATION 1029 (1957).
2. Magnusson, *Postdeath Estate Planning,* 40 IOWA L. REV. 572 (1955).
3. PA. STAT. ANN. tit. 20, § 180.8(a) (1956). For an excellent article concerning a related but significantly different type of election see Westfall, *Estate Planning and the Widows Election,* 71 HARV. L. REV. 1269 (1958).
4. INT. REV. CODE OF 1954, § 2056.

where decedent's will places all his estate in trust for his surviving spouse but does not give her any powers which will allow the trust to qualify as the marital deduction, the income produced by the trust exceeds the spouse's needs, and there is a desire to transfer some of the income to the children-remaindermen of the trust without adverse tax consequences to the spouse, election against the will produces a twofold result. On the one hand, this statutory share which passes outright to the spouse under Pennsylvania law constitutes an interest passing from the decedent to the surviving spouse,[5] qualifies for the marital deduction and may be used to reduce the estate tax.[6] On the other hand, the balance, which would be one-half or two-thirds,[7] would pass to the children immediately without any tax consequences to the spouse.[8] This will reduce income which might have been included in the spouse's gross income and provide income for the possible needs of the children. Although the share passing to the spouse will be taxable at her death, its amount has been greatly reduced and may be further reduced by a judicious use of principal during the spouse's lifetime, or by inter vivos gift. As a result financial as well as practical benefits can be derived by use of the election to take against the will.[9]

Although not within the realm of post-mortem planning, a problem which must be considered because of its possible effects on the marital and charitable deduction is the possibility of shifting interests stemming from WILL CONTESTS and COMPROMISES. The effect upon the marital deduction by a shifting of interests as the result of a will contest is not covered by the Code, but is treated only in the regulations.[10] Generally, if the contest results, whether by court decision or settlement, in the surrender of a property interest by the surviving spouse, the interest so surrendered is considered as having never passed to such spouse and, therefore, cannot

5. INT. REV. CODE OF 1954, § 2056(e)(3).

6. Treas. Reg. § 20.2056(e)-2(c).

7. PA. STAT. ANN. tit. 20, § 180.8(b) (1947).

8. It must be borne in mind that the property interests passing to the surviving spouse by reason of the election can qualify only if all other conditions of the marital deduction provisions are met: Treas. Reg. 105 § 81.47a(f). In states, therefore, where the election gives the surviving spouse only a common-law dower or curtesy interest, such an interest, being terminable, will not qualify. *Cf.* Rev. Rul. 279, 1953-2 CUM. BULL. 275.

9. The preceding example, results achieved, and consequences thereof, is taken from Price, *supra* note 1 at 1049, 1050. For additional examples, see Rodgers and Sterling, *Post-Mortem Estate Planning,* 14 U. PITT. L. REV. 224, 229 (1953). In regard to the question of whether or not the surviving spouse's distributive share is to be determined before or after deducting the federal estate tax see 27 FORDHAM L. REV. 236 (1958); Magnusson, *supra* note 2; and Pennsylvania Apportionment Act of 1951, PA. STAT. ANN. tit. 20 §§ 881-887 (1951); Hagey Estate, 8 Pa. Fiduciary Rep. 301 (1958). *But see* Babcock v. Commissioner, 234 F.2d 837 (3d Cir. 1956) and In re Clark's Estate, 8 Pa. D. & C.2d 665 (1958) where a contrary result was reached in regard to the Pennsylvania Inheritance Tax.

10. Treas. Reg. 105 § 81.47a(g).

qualify. But, if the contest results in the assignment or surrender of an interest to the surviving spouse, it will be deemed to have passed to the spouse only if the surrender or assignment was a bona fide recognition of enforceable rights in the decedent's estate.[11] Of somewhat lesser significance is the effect of the will contest or compromise on the charitable deduction and state inheritance taxes. In applying their local inheritance taxes, most states have adopted one of two conflicting approaches. In a minority of jurisdictions, including Pennsylvania, the tax is based upon the actual distribution under the terms of a bona fide compromise.[12] However, the majority imposes inheritance taxes based on the terms of the will except in those jurisdictions which allow the actual distribution to be controlling if based on a court decision of a litigated will contest.[13] Thus the inheritance tax results vary not only from state to state but even within a state, depending upon what formalities are observed. In regard to property swelling the charitable deduction, the federal courts have avoided this technical morass.[14] If the person or institution contesting the will has a legitimate standing to do so, the charitable deduction is measured by what the charity actually gets.[15] This approach is now embodied in the regulations[16] and rulings.[17]

The third method of post-mortem estate planning, a DISCLAIMER OR RENUNCIATION implies and has been defined, as a complete and unqualified refusal to accept property to which one is entitled.[18] This should be distinguished from an election which implies a choosing between two or

11. *Ibid.* A bona fide recognition will be presumed where a local court has rendered a decision on the merits in an adversary proceeding. Consent decrees or settlement agreements not to contest or not to probate a will will not necessarily be recognized. See Estate of Gertrude P. Barrett, 22 T.C. 606 (1954) where the Court recognized as qualifying for the marital deduction a settlement payment made to the surviving husband to compromise his claim to a share in the estate where it found that the settlement was made in good faith as a result of arms' length bargaining. See INT. REV. CODE OF 1954, § 2056(d).

12. In re Taber's Estate, 257 Pa. 81, 101 Atl. 311 (1917).

13. The cases on the state tax effects of will compromises are collected and reviewed in Black, *The Effect of Renunciations and Compromises on Death and Gift Taxes,* 3 VAND. L. REV. 241 (1950); Tye, *Tax Status of Will Compromise Agreements,* 19 TAXES 350 (1941).

14. Lyeth v. Hoey, 305 U.S. 188 (1938). Although the case was concerned with income taxes, its holding has been carried over and applied in the field of estate and gift taxes.

15. Thompson's Estate v. Comm'r, 123 F.2d 816 (2d Cir. 1941); Nicholas Murray Butler, 18 T.C. 914 (1952); Estate of M. Falk, 18 T.C. 699 (1952).

16. Treas. Reg. § 20.2055-2(c).

17. Rev. Rul. 145, 1953 INT. REV. BULL. No. 16, at 35. The preceding analysis and discussion regarding will contests is noted and further treated in 2 LASSER, ESTATE TAX TECHNIQUES 2197 (1957).

18. No gift tax liability results from a bona fide compromise. Lyeth v. Hoey, *supra* note 14. But see Houseman v. Comm'r, 105 F.2d 973 (2d Cir. 1939), *cert. den.,* 309 U.S. 656 (1940).

more alternatives or choosing to do or not to do some act,[19] and a compromise which implies giving up of something owned or controlled for something.[20]

A disclaimer or renunciation should also be distinguished from a release or relinquishment[21] which implies a giving up of something owned or controlled or a transfer, since the latter normally attracts a gift tax[22] unless within an express statutory exception.[23] Before considering the use of any disclaimer, the following factors should be considered: (1) will the proposed disclaimer be effective under local law,[24] (2) to whom will the disclaimed property pass;[25] (3) particular situations in which a disclaimer may be utilized advantageously tax-wise;[26] and (4) tax consequences thereof. Before discussing the tax consequences, certain non-tax factors merit important consideration. Thus the state of health, life expectancy and independent means of the surviving spouse may be the operative facts of any final determination. And where an heir, devisee, or legatee is involved, the real need for diverting possible dispositions to alleviate a resulting high tax bracket, plus the existence of younger persons to whom property might pass with a consequent saving in income taxes and postponement of possible estate tax liability in the near future, may be controlling in the final analysis.

With this in mind, some relevant gift tax considerations should be noted. The question of gift tax treatment of refusals by heirs or legatees to accept legacies or property from a decedent has proved to be troublesome. The

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19. Treas. Reg. § 25.2511-1. Various aspects of disclaimers are discuseed in the following articles: Lauritzen, *Only God Can Make an Heir,* 48 NW. U. L. REV. 568 (1953); Roehner, *Renunciation as Taxable Gift,* 8 TAX L. REV. 289 (1953); Note, *Disclaimers in Federal Taxation,* 63 HARV. L. REV. 1043 (1950); Benjamin, *Effective Renunciation of Succession in Louisiana,* 26 TUL. L. REV. 81 (1951); Ward, *Practical Aspects of Disclaimers by Donees, Heirs and Legatees,* 16th N. Y. U. INST. ON FED. TAXATION 1937 (1958); Smith, *Property and Tax Consequences of Renunciation and Disclaimers,* 96 TRUST & ESTATES 744 (1957).

20. An election not to exercise a power of appointment may result in a gift tax. INT. REV. CODE OF 1954, § 2514(e). In regard to a widow who elects not to claim against her husband's will which gives her less than her statutory rights, see Estate of Selina J. Gray, 14 T.C. 390 (1950); The Chase National Bank v. Comm'r, 25 T.C. 617 (1955), noted in 96 TRUSTS & ESTATES 30 (1957); Seigel v. Comm'r, 26 T.C. 743 (1956). Where a creditor permits the statute of limitations to run without attempting to enforce his claim see Estate of Eleanor J. Beggs, 13 T.C. 131 (1949).

21. The Code recognizes a distinction between the renunciation and release. INT. REV. CODE OF 1954 § 2041(a)(2) and § 2514(b).

22. Treas. Reg. § 25.2511-2. See also INT. REV. CODE OF 1954 § 2035 (relinquishment in contemplation of death).

23. INT. REV. CODE OF 1954, § 2041.

24. For methods of disclaimer see PA. STAT. ANN. tit. 20, § 301.3(b) (1947).

25. PA. STAT. ANN. tit. 20, § 180.14(9) *et seq.*

26. The most obvious situation which frequently arises is that in which the surviving spouse's potential estate overruns the marital deduction. Other situations involve, but are not limited to, powers of appointment, charitable bequests, and trust benefits. See 2 Lasser, ESTATE TAX TECHNIQUES 2197 (1957).

proposed regulations,[27] following the distinction made by several courts,[28] stated that a renunciation of a vested property interest, where title immediately vested under local law in the devisee or heir at decedent's death, was a taxable gift. Renunciation where title did not immediately vest under local law was not a gift if all the property was renounced within a reasonable time. Thus in the case of intestate inheritance, the disclaiming party subjects himself to a gift tax.[29] The renunciation of a testamentary benefit or legacy, however, incurs no gift tax unless there is no residuary clause and the disclaiming party is the sole intestate heir.[30] This results in a descent of the disclaimer's interest in favor of his children, the disclaimer being ineffective as to the intestate rights and operating as an acceptance of these rights and an assignment of them with consequent gift tax liability.[31] In regard to partial disclaimer, the regulations explicitly state that a disclaimer of only a portion of the property to which one is entitled is not a complete and unqualified refusal within the meaning of the regulations.[32] But a renunciation of one or more of several bequests, which are in fact separate, is a complete disclaimer and will not attract a gift tax, even though all the gifts are contained in a single instrument or in a single paragraph of the instrument.[33] This was the status of the law prior to 1958 when the release of the final estate and gift tax regulations for the 1954 Code occurred.[34] The final regulations avoid the use of the terms "devisee," "renunciation," or "vesting."[35] Instead, they state there is no gift if by local law the beneficiary or heir or next-of-kin may completely and unqualifiedly refuse to accept ownership of the property, and does so. Whether the transfer is effected by will or intestacy is immaterial. There is a gift only if local law does not permit such a refusal, or does not allow the beneficiary or heir to prevent himself from becoming owner of the property. While there has been no litigation concerning the effect of these new regulations, it is felt they will abolish the archaic distinction between "vested" and "non-vested" property rights for renunciation purposes.[36]

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27. Treas. Reg. § 25.2511-1(c), 22 Fed. Reg. 58 (1957). Kay, *Renunciations, Disclaimers,* and *Releases,* 35 TAXES 767 (1957).

28. Lowndes & Kramer, FEDERAL ESTATE AND GIFT TAXES (1956). See cases collected at 682-83.

29. Hardenberg v. Comm'r, 198 F.2d 63 (8th Cir. 1952), *cert. den.,* 344 U.S. 836 (1952); Maxwell v. Comm'r, 17 T.C. 1589 (1952).

30. Brown v. Routzahn, 63 F.2d 914 (6th Cir. 1933), *cert. den.,* 290 U.S. 641 (1933).

31. Maxwell v. Comm'r, *supra* note 29.

32. Treas. Reg. § 25.2511.1.

33. Brown v. Routzahn, *supra* note 30.

34. See Lowndes, *Summary and Analysis of Final Estate Tax Regulations,* 97 TRUSTS & ESTATES 708, 787 (1958); Rodman, *New Estate Tax Regulations on Estates of Nonresidents not Citizens,* 97 TRUSTS & ESTATES 712 (1958).

35. Treas. Reg. § 25.2511-1(c) (1958).

36. Frankel, *What To Do About Renunciation Of Bequests And Related Problems,*

With these gift tax consequences in mind, the following estate tax considerations should also be borne in mind. When planning to utilize the disclaimer and the marital deduction, it should be remembered that property which passes to a widow by reason of a third party's disclaimer does not qualify for the marital deduction. The reason is that the renounced property is considered, for purposes of the marital deduction,[37] to have passed from the decedent to the claimant and then to the widow, regardless of local law concepts.[38] Yet, a surviving spouse's disclaimer will reduce the allowable marital deduction since the renounced property is considered, for purposes of the marital deduction, to pass from the decedent directly to the person benefiting from the disclaimer.[39] As a result, where more property qualifies for the marital deduction than can be utilized, it may be possible to reduce the amount qualifying by renunciation. But this can only be intelligently decided after first determining the gift tax consequences. Thus, renunciation of a surviving spouse's legacy results in no gift tax[40] and may be used effectively for tax as well as non-tax benefits.[41]

When made prior to the date prescribed for the filing of the estate tax return, an irrevocable disclaimer of an interest, which thereby falls into any bequest, legacy, devise or transfer to a charitable organization, will be allowable as a charitable deduction.[42] Thus, a renunciation of the power to invade the corpus of a trust, which would otherwise disqualify a remainder interest for the charitable deduction will make a charitable deduction possible and enlarge it, depending upon the restrictions in the instrument pertaining to the

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2 Lasser, ESTATE TAX TECHNIQUES 2190 (1959). The test of the final regulations seems more satisfactory and not so strictly confined to technical concepts of property law as that of the proposed regulations. Kramer, *Federal Estate and Gift Taxation,* 34 N. Y. U. L. REV. 213, 229 (1959).

37. The rules on how property is considered to pass after a renunciation are expressly limited to the determination of what marital deduction is allowable. Consequently a third party's renunciation in favor of a surviving spouse is not thereby necessarily making a taxable gift to the spouse. The general principles heretofore discussed will determine this.

38. INT. REV. CODE OF 1954, § 2056(d)(2).

39. INT. REV. CODE OF 1954, § 2056(d)(1).

40. Brown v. Routzahn, *supra* note 30.

41. For example, suppose decedent's will granted a life estate to the surviving spouse with remainder over to children and grandchildren. The surviving spouse may have come from a long-lived family and be in excellent health. If the surviving spouse should live to be a very old age, it might be years before the children or grandchildren would receive any economic benefit from the remainder interests. The benefits are frozen during the lifetime of the surviving spouse. In order to prevent this freezing of benefits, renunciation by the spouse will operate to accelerate the remainder interests unless a contrary intent is shown in the will. Magnusson, *supra* note 2, at 576. If the surviving spouse does not wish to give substantial assets outright immediately nor terminate the trust, disclaimer of the income from the life estate is possible if no acceleration results by operation of law. Thus trust income accruing subsequent to renunciation will not be taxable to her. See First Nat'l Bank of Portland v. Comm'r, 39 B.T.A. 828 (1939).

42. INT. REV. CODE OF 1954, § 2055.

invasion privilege.[43] As a result, the estate tax is reduced and the amount of corpus earning income for the life tenant is correspondingly increased. Renunciation should only be seriously considered where it is unlikely that resort to principal will be necessary. Otherwise, practical considerations would probably outweigh tax considerations in this area.

It should also be noted that although the estate of a legatee who died subsequent to the testator might benefit if the legatee renounced, it would appear that the executor of the legatee's estate would have no right to disclaim,[44] unless conferred directly by statute.[45] Further, a disclaimer of a general power of appointment created after October 21, 1942 may result in favorable tax consequences since a disclaimer attracts no gift tax liability.[46]

A fourth and equally important, as well as effective, post-mortem estate planning method is involved through the use of the ALTERNATE VALUATION DATE. An investment hedge can be obtained by the estate since the executor is afforded the option to value assets for estate tax purposes either on the date of death or one year later.[47] Thus, as explained by one writer, the United States Treasury assumes the economic burden of the loss in a proportion equal to the estate tax bracket of the estate. It does not share, on the other hand, in any gain due to appreciation of investments so far as estate taxes are concerned.[48] Hence, in selecting a valuation date, the following should be considered: (1) It may be advantageous not to sell sound investments that have potential appreciation, especially where the immediate conversion to cash will most likely cause a rather substantial loss of income;[49] (2) Where there is a small taxable estate, or, due to the allowable deductions, no taxable estate, such election might be appropriate where the estate tax on the increased value at the later valuation date is lower than the income tax which would be applicable to a gain realized on a later sale of the assets, or where the deductible depreciation on the higher basis of the assets will thereafter be advantageous;[50] (3) Since, under Sections 2032(b)(2) and 2056, the amount of the marital deduction is determined with regard to the valuation date, the election of the higher value may have

43. Estate of Ida F. Doane, 10 T.C. 1258 (1948).
44. In re Howe's Estate, 112 N. J. Eq. 17 (1932).
45. RHODE ISLAND, L. 1947, Ch. 1974, §§ 24-25.
46. INT. REV. CODE OF 1954, § 2514(b). Possible example of tax saving through disclaiming a power of appointment is where elderly surviving spouse's estate is potentially larger than decedent's estate. In regard to life insurance settlement options, see Rodgers and Sterling, *supra* note 9 at 225.
47. INT. REV. CODE OF 1954, § 2032. In regards to how the election is made, see §§ 2032(c), 6075(a), 6081. In regards to timely filing see Estate of Downe, 2 T.C. 967 (1943); Estate of Doriss, 3 T.C. 219 (1944); Estate of Flinchbaugh, 1 T.C. 653 (1942). The election may also be made by an amended return. See Treas. Reg. § 20.2032-1(b)(2).
48. Garrett, *Post-Mortem Estate Planning*, 98 TRUSTS & ESTATES 1194 (1959).
49. *Ibid.*
50. FIDUCIARY REVIEW, Sept. 1959, p. 2.

the effect of increasing the bequest to a surviving spouse where there is a marital deduction formula clause, with the increased taxes diminishing only the amount of assets passing to other legatees;[51] and (4) Since, under Section 2032(b)(1) and 2055(f)(1) of the Code, the amount of charitable deduction is also dependent on the valuation date, higher valuation of the property passing to the charity can result in a lower tax in the estate.[52] It should be remembered that there are two modifications to the general rule that when the alternate valuation date is chosen, all property included in the gross estate is valued as of that date. Where property has been distributed, sold, exchanged, or otherwise disposed of within the year following death, it is valued as of the date of such disposition;[53] and where the value or property is affected by mere lapse of time, it is valued at the date of death, despite the election of the alternate valuation date.[54] In exercising the option to value property at the later date, it must be remembered that the later date will apply to *all* property interests forming part of the gross estate and cannot be applied as to some property interests and excluded as to others.[55] If the estate is under $60,000, so that no return need be filed, no election can be made in a voluntary return in order to obtain a higher income tax basis than date of death values.[56] Although originally intended to prevent the "danger of complete confiscation of estate due to sudden decline in market values,"[57] the availability to the post-mortem estate planner of the use of alternate valuation date provides another method for the effective savings on estate as well as income taxation. It is one which should never be overlooked.

A fifth method which may be utilized is the REDEMPTION OF ELIGIBLE GOVERNMENT BONDS to satisfy part or all of the estate tax due.[58] While these bonds will be valued at par for purposes of satisfying the estate tax, they are only ascribed their fair market value as an asset of the estate on the appropriate valuation date.[59] Substantial savings may be

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51. *Ibid.*

52. *Ibid.*

53. INT. REV. CODE OF 1954, § 2032(a)(1).

54. INT. REV. CODE OF 1954, § 2032(a)(3).

55. Rosenfield v. United States, 156 F. Supp. 780, *aff'd,* 254 F.2d 940 (1957). See also Treas. Reg. § 20.2032-1(b)(2). A problem which frequently arises where the alternate valuation date is elected is the very common one of the extent to which income items are to be included in the gross estate where the alternate valuation date is elected. See FIDUC. REV., *supra* note 50, and Price, *Alternate Valuation Date Problems,* 17th N. Y. U. INST. ON FED. TAXATION 1245, 1253 (1959).

56. Treas. Reg. § 20.2032-1(b)(1); see Rev. Rul. 56-60, 1956-1 CUM. BULL. 443.

57. S. REP. No. 1240, 74th Cong., 1st Sess., p. 9 (1935).

58. INT. REV. CODE OF 1954, § 6312; Treas. Reg. 301.6312; 31 C.F.R. part 306.

59. Banker's Tr. Co. v. United States (D.C.S.D., N.Y., Nov. 5, 1959), 59-2 U.S. Tax Cas. ¶ 11,913; annot. FIDUCIARY REVIEW, December, 1959.

achieved in this manner due to the present low cost of acquisition of such bonds which results in a fairly high effective income return to the purchaser prior to death. Since only those eligible series that are owned by the decedent at death and constitute a part of his estate qualify for redemption, acquisition of such bonds is a matter of lifetime estate planning.[60] Some degree of post-mortem planning is involved, however, for the personal representative must be careful to deal with the bonds so as to preserve their qualification.[61] [Editor's note: Subsequent to the submission of this article, the Circuit Court of Appeals of the Second Circuit has reversed the district court on the above mentioned method. In *Bankers Trust Co.,* 2 CCH Fed. Est. & Gift Tax ¶ 11985, the circuit court stated that the bonds must be given a value for estate tax purposes of at least par.]

## INCOME TAX CONSIDERATIONS

There are also various methods of effecting a post-mortem estate plan which have a direct effect upon the income tax. Since the scope of this article is limited, only a brief reference to each will be made. This in no way should be taken as any indication of the importance of considering income tax consequences in post-mortem estate planning, nor should it foreclose any possibility of further investigation into the problems and ramifications therein involved. The following is merely intended to create a basic awareness of devices which should be considered for income tax savings in the decedent's last income tax return, the estate's income tax return, the surviving spouse's return, and the beneficiaries' returns.

Death brings to an end the taxable year of the decedent. The decedent's final return covers, therefore, the income from the beginning of the taxable year up to and including the date of death.[62] It is possible, however, that two returns may have to be filed by the executor and/or attorney. This will occur where the decedent dies early in the year without having filed a return for the prior year. In dealing with the decedent's final income tax return, the post-mortem estate planner may be presented with an opportunity to effectuate savings through utilization of the following devices.

First, there is a valuable privilege for the personal representative and surviving spouse to file a JOINT RETURN for that portion of the decedent's taxable year ending with his death and covering the surviving spouse's

60. 31 C.F.R. § 306.28(b).

61. See FIDUCIARY REVIEW, *supra* note 59 at p. 2 wherein enumerated transactions where qualification is lost or preserved through various transaction and references to C.F.R. therein.

62. In regards to when the decedent's final income tax return is due and what items of income and deductions are to be included in that return see Bowe, *Income Tax Problems of Executors,* 32 ROCKY MT. L. REV. 42 (1959).

entire taxable year.[63] The tax advantages of income splitting that a joint return affords are obvious.[64] Two considerations which may be influential in a determination to file a joint return are: (1) where a joint return is employed, an equitable division of liability between the estate and the spouse must be made;[65] (2) since the liability for the tax thereon is joint and several,[66] the ability of the surviving spouse to pay a share of the liability should be ascertained, as should the existence of transactions which might lead to the assertion of the fraud penalty.[67] It should be remembered that if a refund on the joint return is received for an over-payment of the tax, ownership of the refund is determined by the conduct of the husband and wife during their joint lifetime.[68] Thus, where the husband and wife file a joint declaration of estimated tax prior to the husband's death, the joint declaration and payment during their joint lifetime gives rise to an indication of joint ownership to the right in the refund. This right to the property is held as tenants by the entireties and passes by right of survivorship to the wife, therefore, forming no part of the decedent's estate.[69] On the other hand, failure by the decedent during his lifetime to elect to file a joint return renders impossible a finding that the husband has given his wife a joint interest in the refund. Rather, the refund taxes which initially were withheld from the husband's earnings remain his individual property, therefore, includable in the decedent's estate.[70]

63. INT. REV. CODE OF 1954, §§ 2(a), 6013(a)(3),(b)(1). The conditions as stated by the Regulations at 118, Section 39.51-1(b) and set forth in the code under Section 6013 must be satisfied before the privilege may be exercised.

64. For example, if the calendar year taxpayer dies December 15, 1960, it normally would be to the executor's advantage to file a joint return with the surviving spouse for 1960, inasmuch as the income from 1-1 to 12-15, 1960 attributable to the decedent could have the benefit of the lower brackets found on a joint return. In such case, the surviving spouse's return would include her entire taxable year. If, however, the decedent died on 1-15, 1961, the only income that would be included in his final return would be the income from 1-1 to 1-15, 1961. A joint return thus would result in a higher tax rate on the decedent's income than if separate returns were filed. If a joint return is nevertheless used, the income of the surviving spouse for the entire year would have the advantage of the lower joint return brackets.

65. The reason for this rule is that there is always the possibility that those interested in the estate may be damaged unless the estate pays no more than its tax would have amounted to had the executor filed an individual return. See Rev. Rul. 56-290, 1956-1 CUM. BULL. 445 and Rev. Rul. 57-58, 1957-1 CUM BULL. 300 and Treas. Reg. § 20.2053-6(f) about amount of estate tax deduction for income tax paid by estate. See also FIDUCIARY REVIEW, July 1959, p. 1.

66. INT. REV. CODE OF 1954, § 6013(d)(3).

67. Myrna S. Howell, 10 T.C. 859, *aff'd* 175 F.2d 240 (6th Cir. 1949), in which the wife held liable for fraud penalty although the wrongful acts were committed by her husband.

68. "It is not the Federal authorization for the filing of a joint return by survivor and personal representative which determines ownership of a refund shown to be due in such return, but rather the conduct of husband and wife during their joint lifetime." FIDUCIARY REVIEW, July 1959, p. 2.

69. Green Estate, 8 Fiduc. Rep. 297 (1958).

70. MacNeill Estate, 9 Fiduc. Rep. 386 (1958); noted in FIDUCIARY REVIEW, *supra* note 68.

Secondly, if decedent's LIFE INSURANCE is involved, it may be well to consider the election by the surviving spouse beneficiary of installment payments to obtain the 1,000 dollars interest exclusion from gross income.[71]

Thirdly, where U.S. SAVINGS BONDS are involved, a frequently overlooked tax saving devise is the exercise of the election to accrue the interest in decedent's final income tax return.[72] If no election is exercised, income is realized upon the redemption of the bonds measured by the difference between the cost to decedent and proceeds of the redemption. If the tax bracket of the decedent's final return is low because of the shortness of the period, the exemption and deductions, it may be wise to make the election in such return to accrue the interest up to that date and have it taxed at the lower bracket.

The bulk of the income tax problems and savings that will necessitate close scrutiny by the executor and/or attorney are those which are concerned with the general scheme of income taxation of an estate. The following devices should be given careful consideration by the post-mortem estate planner.

An estate under administration is a separate tax paying entity subject to the same income tax imposed on an individual.[73] In general, the income and deductions are computed in the same manner as for an individual[74] except that: (1) an estate is entitled to a personal exemption of 600 dollars for each taxable year, whether a full year or not,[75] (2) an estate cannot claim a standard deduction,[76] and (3) the charitable deduction is unlimited, but only for amounts of income paid or set aside according to the will.[77] Therefore, since the progressive income tax rates of the Code provide advantages in dividing income among as many legitimate tax entities as possible, it may be advantageous to PROLONG SETTLEMENT or CONTINUE ADMINISTRATION of the estate to utilize the low income brackets afforded by the additional taxable entity. However, the Code does provide that the settlement period is the period actually required by the executor to perform the ordinary duties of administration.[78] Thus, administration cannot be unduly prolonged and may be considered terminated for federal income tax purposes after a final account has been filed, when the assets have been distributed, when the executor and trustee are one and the same, or when for any other reason, actions of the executor are no longer essential for the

71. INT. REV. CODE OF 1954, § 101(d).
72. INT. REV. CODE OF 1954, § 454(a); Fiduciary Review, March 1960, p. 3.
73. INT. REV. CODE OF 1954, § 641.
74. INT. REV. CODE OF 1954, § 641(b).
75. INT. REV. CODE OF 1954, § 642(b).
76. INT. REV. CODE OF 1954, § 142(b)(4).
77. INT. REV. CODE OF 1954, § 642(c).
78. Treas. Reg. 1.641(b)-3.

administration of the estate.[79] Further, in ascertaining when an estate closes, the federal taxing authorities will not be bound by determinations of local probate courts in non-adversary proceedings; each case will be decided in the light of the Code, Regulations, and previous case histories.[80]

Another device by which substantial savings may be realized exists in the estates right to CHOOSE ANY FISCAL YEAR it desires, so long as the period selected ends on the last day of a calendar month, and, in the first year, is not for a period of more than twelve months.[81] Where an unusually large income item is received by the estate within the first few months of administration and the income is not required to be distributed, selection of a first short year has the effect of keeping the income during that short period in a lower tax bracket than it would be if that same income were added to additional income and taxed in a longer first taxable period.[82] Similarly, use of the short year at the close of the estate will permit excessive deductions in the year of termination of an estate to be taken by the beneficiaries on their individual returns.[83] Thus, if the beneficiaries happen to be in a higher tax bracket than the estate, it will be advantageous to put as many of the deductions as possible into the last year of the estate. This will have the effect of enabling the beneficiaries to take advantage of those deductions on their individual returns. Hence not only will the selection of the fiscal year permit a leveling of income within tax periods of the estate, but it will also determine when the beneficiary must include distributions from an estate in his income.[84] However, there is always the possibility that estate income of a longer period than twelve months may be included in a beneficiary's gross estate, if his tax year is different from the tax year of the estate and if partial distributions are made.[85]

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79. See cases and discussion of Camilli, *When Estates and Trusts Terminate,* 99 TRUSTS & ESTATES 370 (1960).

80. *Id.* at p. 372.

81. INT. REV. CODE OF 1954, § 441.

82. Further, suppose a decedent died 2-1-60, survived by a widow and no dependents, leaving securities which produce an income of $1,000 a month, the estate terminating on 12-31-61. For the regular calendar year 2-1-60 to 12-31-60, the $11,000 of estate income would be taxed at $2,792. For the period 1-1-61 to 12-31-61, the $12,000 of individual income would be taxed at $2,792. Total tax due would be $5,584. By choosing a fiscal year from 2-1-60 to 6-30-60 with $5,000 being taxed at $994 and 7-1-60 to 6-30-61 with $12,000 being taxed at $3,172 to the estate and 7-1-61 to 12-31-61 with $6,000 being taxed at $1,048 to the individual, a total of $5,164 is due instead of $5,584. See, Price, *supra* note 1.

83. INT. REV. CODE OF 1954, § 642(h). There are, however, two exceptions to this rule. Treas. Reg. 1.642(h)-2 provides that no unused deduction will be allowed for the personal exemption of Section 642(b) nor the charitable contribution of Section 642(c).

84. INT. REV. CODE OF 1954, § 662(c).

85. For instance, if, in the example at note 82, the estate had distributed the $12,000 income anytime prior to 6-30-61, the beneficiary would have been taxed on $18,000 in 1961 since income distributed in any taxable year of an estate is taxed in the beneficiary's taxable year in which such estate's taxable year terminates. See Treas. Reg. 1.662(c)-1.

An additional method of post-mortem planning which must be considered in conjunction with the devices heretofore mentioned is that involved in PLANNED DISTRIBUTIONS. Preliminarily, it should be noted that opportunities to effect savings through this device are primarily limited to those estates in which there is no requirement of distribution of income and all distributions are discretionary. It is only in this situation that the executor is in a position to make substantial savings in taxes by proper timing of the distributions from the estate. Mandatory distributions allow no choice as to whether the income will be taxed to the beneficiary rather than the estate, irrespective of whether or not there is an actual distribution.[86] The only opportunity to benefit by such mandatory distributions exists in the choosing of a fiscal period for the estate which will result in the income being taxed to a beneficiary at the most advantageous time. It should also be noted that the Code invokes a conduit theory so as to tax all, but no more than all, of the estate's taxable income either to the estate or to the beneficiaries. It also provides that an estate is entitled to deduct for income purposes distributions of property made by it, subject only to the exception that a specific bequest will not be regarded as deductible by the estate and taxable to the recipient, thus leaving the estate income taxable to the estate.[87] With these propositions in mind, the following post-mortem estate planning opportunities should be considered: (1) Distribution of income to beneficiaries whose income tax brackets are lower than that of the estate; (2) Relative merit of accumulating some or all income for the beneficiaries in higher tax brackets, thus taxable to the estate and later distributed free of tax to the beneficiaries; (3) Desirability of making a partial distribution to a beneficiary shortly after a decedent's death, minimizing the extent of the shift to the higher bracket distributee by the selection of a short period for the first fiscal year and perhaps the payment of a portion of administrative expenses in that short period; (4) Merit in the bunching the payment of administration expenses in that short final period so that the amount of the expense carry-over to the higher bracket distributee can be increased; (5) Distribution of sufficient income to equalize income tax brackets of the joint return where decedent dies in the early part of the year and considerable income is received by the estate thereafter; and (6) Distribution of sufficient income so that the taxable income of the joint return doubles that of the estate's return, causing the top brackets of both returns to be the same, resulting in the lowest total income taxation.[88] It should be remembered that any distribution during administration is treated as a distribution of income, to the extent of the estate's dis-

86. INT. REV. CODE OF 1954, §§ 661(a)(1) and 662(2)(1).

87. INT. REV. CODE OF 1954, §§ 661, 662, 663, 643(a) and 642(3).

88. See Cavitch, *How to Time Estate Distributions to Shift Taxes, Avoid Attribution Complications,* 10 J. TAXATION 288 (1958); Williams, *Picking a Fiscal Year, Timing and Nature of Distributions,* 20 OHIO ST. L.J. 16 (1959); Price, *supra* note 1.

tributable net income, unless it is a payment of a bequest of a specific sum of money which is distributed in not more than three installments or unless it is a bequest of specific property.[89]

## INTER-RELATION BETWEEN THE ESTATE AND INCOME TAX

A third area of estate planning, one which has been referred to as the "executor's dilemma,"[90] evolves about formulating decisions concerning the elections and discretions of the post-mortem estate planner arising from the income tax and estate tax. This involves the interplay of various sections of the Code, all of which have a direct affect on both taxes.

Basically, during the course of administration, a post-mortem estate planner may have expenses, losses, or payments which can be used as tax deductions in one of the following ways: (1) for estate tax only, (2) for income tax only, (3) for both estate tax and income tax, (4) for either estate tax or income tax, as elected by the executor. The first three types do not pose problems involving a choice to the executor or persons interested in the estate. Absent testamentary direction, the executor's duty is presumably to use his reasonable efforts to make full use of them as deductions. With regard to certain other expenditures qualifying under the fourth type,[91] the executor possesses a right, one which imposes a serious obligation upon the executor to be certain that he exercise it prudently, to select the method to be used in deducting expenses for federal tax purposes.[92] After the executor has determined what expenses are supportable deductions under both income and estate taxes and are therefore subject to his election, he faces three questions: (1) the mechanics of exercising and preserving his right, (2) the tax dollar effects of the alternatives, (3) the effects those alternatives may have on the distribution of estate income and corpus, and shifting of tax benefits and burdens among beneficiaries.

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89. INT. REV. CODE OF 1954, § 663(a)(1).

90. Bronston, *Elections and Discretions Under the Code; The Executor's Dilemma,* 35 TAXES 986 (1957).

91. Generally those expenses under Sections 2053 and 2054 such as administration expenses, medical and related expenses of last illness paid within one year, etc. are the ones involved herein. However, it should be noted and remembered, although no reference in the body herein will be made, that when the beneficiary is also executor or administrator it would be wise to consider whether he should waive commissions in writing before undertaking any duties of administration and save personal income tax, or take commissions and save estate income tax or Federal estate tax. See Rev. Rul. 56-472, 1956-1 CUM. BULL. 21.

92. This problem is currently receiving increasing attention. See Cox, *Executors Election to Claim Certain Deductions for Income or Estate Tax Purposes,* 20 OHIO ST. L.J. 23 (1959); Bowe, *Income Tax Problems of Executors and Administrators,* 32 ROCKY MT. L. REV. 66 (1959); Randall, *Consequences of Executors Elections as to Administrative Expenses,* 15th N.Y.U. INST. ON FED. TAX 1011 (1957); Sutter, *Election to Deduct Expenses for Estate or Income Taxes,* 3 J. TAXATION 357 (1955); Bronston, *supra* note 90; FIDUCIARY REVIEW, Nov. 1958, p. 1.

The first of these questions presents little difficulty and reference to the Code provisions is sufficient.[93] The second involves many of the methods discussed under other headings of the paper such as closing the estate, selecting a fiscal year, effect on the marital deduction and others. These should all be considered, as well as a measurement of the comparable tax rates against the affected tax base. Generally as a result of the election, if the estate tax goes down, the income tax goes up. Conversely, income taxes might be saved at the price of an increase of estate tax. Boehm, in an excellent article, sets out two general principles which cover this area:[94]

> Where the maximum marital deduction is not available, assuming sufficient offsetting otherwise taxable net income, in any net estate up to $100,000 in value, it is always less expensive to use expenses for income tax purposes than as estate tax deductions.[95]

and

> Where the maximum marital deduction is available in an estate, assuming sufficient offsetting otherwise taxable net income, in any full marital deduction up to $2,000,000, it is always less expensive taxwise to use expenses for income tax purposes in preference to estate tax deductibility. In most estates, the breaking point may easily pass $4,000,000.[96]

Putting it another way, it takes an estate of 1,000,000 dollars to reach a federal estate tax rate of 39 per cent, whereas income of only 10,000 to 12,000 dollars reaches a comparable rate for federal income tax purposes. From these it can be concluded that almost all smaller estates, and many larger ones, will probably require use of the income tax alternative deduction in preference to reducing the size of the net taxable estate.

In regards to the third question, the exercise of the election may have a varied effect on beneficiaries. For example, the use of the deductions for income tax instead of estate tax will increase the amount to which a spouse would be entitled under a marital deduction formula bequest.[97] If a residuary bequest to a charity is involved, the election to claim the expense as an income tax deduction will reduce the amount of the charitable deduction allowable for estate tax purposes.[98]

The question arises, then, as to whether or not the executor may act

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93. INT. REV. CODE OF 1954, §§ 642(g), 2053 212 and regulations thereunder. See also Randall, *supra* note 92 at 1011 and Cox, *supra* note 92 at 26.

94. Boehm, *Comparing the Relative Tax Costs of Alternative Treatment of Estate and Income Deductions and Valuation Adjustments,* 31 ROCKY MT. L. REV. 172 (1959).

95. *Id.* at 173.

96. *Ibid.*

97. Estate of Levy, 167 N.Y.S.2d 16 (Surr. Ct. 1957). See Rev. Rul. 55-643, 1955-2 CUM. BULL. 386; Rev. Rul. 55-225, 1955-1 CUM. BULL. 460. For more detailed discussion of the problems involved see note, *Drafting Martial Deduction Provisions,* 64 DICK. L. REV. 425 (1960).

98. See example noted in Randall, *supra* note 92 at 1019, 1020.

arbitrarily in exercising his election. There is nothing in the federal statute to guide him in his choice and there is little local law. As pointed out, there seems to be general agreement that there should be an election of the option that will produce the least amount of overall tax. The cases have held, however, that there should then be an equitable allocation of the tax savings between the various beneficiaries under the will. In a leading article on this subject the author states:

> No court has suggested that the executor is not free to exercise the choice conferred by Section 642(g) with respect to the use of deductions. Presumably, the executor should, absent contrary instructions in the will, exercise the choice for the good of the estate as a whole. The executor's primary duty in dealing with the deductions is to keep taxes to a minimum and thus preserve the assets of the estate.
>
> The local courts have, however, shown concern over the effect of shift of deductions to the income tax where the will creates trusts. The most important deductible expenses involved are charges against principal account. Traditionally, these deductions have been taken for estate tax purposes. This traditional use also satisfied concepts of equity; principal account, having borne the expenses, properly receives the tax benefit flowing from their deductions. However, if the deductions are shifted to the income tax, principal account still is charged with the expenses but income account reaps the tax benefit. The remaindermen are saddled with additional estate tax and the income beneficiaries receive untaxed income.
>
> The courts of two states have required adjustments in fávor of the remaindermen. Income account must, under these opinions, reimburse principal account so that the latter is in the position it would have been if the expenses would have been taken as estate tax deductions. Any excess of the income tax saving over the estate tax increase remains with the income beneficiaries. Estate of Edward H. Warms, 140 N.Y.S.2d 169 (Surr. Ct. 1955) Estate of Bixby, 140 Cal. App. 326, 295 P.2d 68 (1956).[99]

In Pennsylvania, in a case where the executors elected to claim certain expenses as income tax deductions thereby achieving overall tax savings but increasing the federal estate tax burden, it was held that an amount equal to the increase in federal estate tax caused by the election must be transferred to principal from income and be charged proportionally against the income beneficiaries.[100] Thus, it seems clear that whenever an election bene-

99. Lewis, *Shifting of Deductions from Estate to Income Tax Returns*, A.B.A. SECTION OF REAL PROPERTY, PROBATE AND TRUST LAW, REPORT OF PROCEEDINGS OF PROBATE AND TRUST LAW DIVISIONS, 93, 97 (1958).

100. Bell Estate, 7 Pa. Fiduc. Rep. 1, *aff'd* 393 Pa. 623 (1958), annot. FIDUCIARY REVIEW, November 1958. See also Estate of Rice, 8 Pa. D. & C.2d 379, 6 Pa. Fiduc. Rep. 225 (1956).

fits income at the expense of principal, appropriate adjustments may be required.

Since the case law on adjustment for the effects of the executor's election on competing interests is still in the incipient stage, guideposts and problems can only be tentative and partially answered. Thus, the following rules should be considered in a decision to make an appropriate deduction: (1) A post-mortem estate planner should carefully consider the tax effects of his deduction election. When possible he should take it where it does the most good tax-wise. (2) It is not sufficient to weigh the respective tax rates alone. If there is a formula type of marital trust, there may be, in addition to the increase in estate tax, a swing of principal from the residuary estate to the marital share because of the larger adjusted gross income. (3) Receipt of a benefit should bear its correlative tax burden. The person or account charged with an expense is entitled to the correlative tax benefit. However, it seems doubtful that an executor has inherent power to make adjustments, absent express power in the will.[101]

In conclusion, it could be said that the modern post-mortem estate planner's role is difficult as well as important. His task is complicated by the inter-related provisions of the estate and income taxing statutes. He is confronted with the duty of working out a plan that will produce the most favorable tax results for the estate and beneficiaries. He is presented with a number of alternatives that must be examined and weighed in effectuating such a plan. This means, as a practical matter, making a great many computations and extensive examination of the law involved. It also may mean a through awareness of the non-tax considerations which are operative among the individual beneficiaries. But in the final analysis, it means, and in most cases to the satisfaction of those involved, effecting substantial tax savings through post-mortem estate planning.

101. Cox, *supra* note 92. The author notes that the executor, after having determined his better election course from practical and economic aspects may: (1) dodge the problem of adjustment of the effect of the election by deducting the expense on the return which does not produce distortion at the cost of paying more taxes. But he points out that such action runs the risk of complaint by estate beneficiaries. (2) Seek instruction of the probate court. But as pointed out, this may be costly and time consuming. (3) Bring together the affected beneficiaries, with their counsel, and seek their concurrence in the proposed course of election. But Gradwohl, *Probate Income Tax*, 37 NEB. L. REV. 329 (1958) at 362, note 120, warns, "To the extent that the parties intentionally engage in a manipulation of income tax which is later reimbursed by the benefiting parties, there would appear to be the possibility of added income tax consequences to either the party whose income tax is reimbursed by another, or to the party whose income tax is paid for him for a fee."